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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

Major Rail Consolidation Procedures

COMMENTS OF
DAKOTA, MINNESOTA & EASTERN RAILROAD CORPORATION

Dakota, Minnesota & Eastern Railroad is an 1,121-mile regional railroad operating in five states (WY, SD, MN, IA, & NE). Our primary commodities are grain and other agriculture related products, clay, wood and paper products, and cement. We currently have pending before the STB an application to construct and operate a third rail line into the Wyoming Powder River Coal Basin ("PRB") for the purpose of, among other things, (a) improving service and injecting new competition into the important PRB market, (b) preserving and improving service in DM&E's existing market area, and (c) relieving pressure on an overtaxed national rail infrastructure system (STB Finance Docket No. 33407). That project would also result in the complete rebuilding of our existing mainline.

ISSUE BACKGROUND

Because of a plethora of unmeasured impacts, nuances of individual agreements and cumulative impacts of missed opportunities, major rail consolidations have significantly restricted competition within the railroad industry. The Surface Transportation Board does not have the resources to accurately assess -- much less develop effective mitigation for -- the full range negative competitive impacts mega rail mergers create for Class II and III railroads. Reregulation of the railroad industry is not the solution. Enhanced competition is. A goal of future mergers should be to preserve and restore competition wherever possible. A significant part of the answer is already in place through a vastly underutilized resource within the rail industry -- the Class II and III railroads. If they are allowed to work together, with modest connectivity requirements imposed on the merging Class I railroads who hold the keys to anti-competitive paper and steel barriers, they can form a series of networks that will bring creative new competitive opportunities for shippers around the country.

Federal law requires the STB to protect and promote a competitive rail infrastructure. Congress left the role of determining to what extent mergers will be scrutinized and conditioned to the discretion of the STB. The current balancing test is a broad brush effort that does not consider many real world merger impacts which both eliminate existing competition and stifle opportunities for future competitive initiatives. The scaleplate for the potential harm that mega mergers could have on the public is artificially light under the present merger rules. STB's initiation of ex parte 582 to reassess the rules in that regard is encouraging and timely.

Class I consolidation in recent decades has altered fundamentally the competitive landscape for Class II and III railroads. It makes new market access opportunities and customer service innovations more difficult for the Class II and III railroads to achieve. It makes it increasingly difficult for smaller railroads to tap into the national rail transportation network to reach the major markets necessary to keep our customers competitive in their respective industries. We no longer have the range of competitive options previously available, and have lost through past mergers many credible prospects for competitive connections that provided important competitive leverage for some smaller lines. Even though a connection might not be in use, its availability goes a long way toward securing competitive benefits. The contracts which accompanied many "spin off" line sales created paper barriers that by design were intended to limit competitive access. Beyond these technical contractual barriers, the resulting infrastructure of past consolidations is such that it creates many steel barriers that prevent competitive connectivity as well -- sometimes by design, sometimes by chance. The bottom line is that as the major Class I's consolidate, it is far more difficult for Class II and III railroads to network their systems to gain access to key markets beyond our immediate reach. Meaningful competitive solutions to the continuing Class I consolidation require competitive access to major markets. This can be achieved by the elimination of steel barriers (via trackage rights, haulage requirements, divestitures, etc.) and paper barriers (via voluntary or conditioned contract restructuring).

For DM&E directly, the outcome of ex parte 582 could determine the ultimate feasibility of a pending $1.5 billion, 1,000-mile railroad construction and revitalization project. This project would have a very positive impact in our existing service area, and open up new opportunities to additional shippers in the PRB and elsewhere. The project depends on new rail construction on the west end of our existing line, and equally upon the retention of competitive transportation options on the east end of our line for final delivery to energy producing utilities and other customers. The potential for developing those competitive connections is strong with the infrastructure in place today. The market place incentives will make it happen. After a final round of mega mergers, however, many of those incentives would be dramatically realigned. Lines which today have every incentive to work with us could become part of BNSF or UP, which already serve the PRB today. They then would be incented to prevent competition. The viability of the project could be lost without adequate and clear guidelines coming out of this proceeding which provide certainty to the financial community that competition will not be further sacrificed in this round of mergers. Specifically, with our project for example, two existing competitive connection opportunities likely to be lost include both the Canadian National Railroad (seeking to merge with PRB carrier BNSF) and the Canadian Pacific Railroad (which potentially could be merged with the other PRB carrier, Union Pacific Railroad). Whether UP and CP actually would merge in response to the CN/BNSF or not is largely irrelevant. For that matter, in light of the attention already given to the CN/BNSF merger, whether it is actually consummated or not is somewhat irrelevant. The damage was done the day CN and BNSF announced their proposal. It created significant uncertainty and instability with respect to the future of the competitive landscape relative to our eastern connection opportunities. To re-establish stability and certainty will require an affirmative assurance to the marketplace that our competitive connections will be effectively maintained in any future merger. If the potential for these kinds of mergers exist without adequate pro-competitive condition guidelines coming out of this rulemaking, it seems unlikely that any investor is going to risk $1.5 billion. The guidelines need to make clear that the competitive opportunities and incentives which exist on our east end today will not be lost to future mergers.

Beyond the concern relative to our construction and rail revitalization project, the mega mergers present immediate operational threats to our railroad that are similar to those faced by many other regional and shortline railroads in the country, as discussed in the testimony of the American Short Line and Regional Railroad Association (ASLRRA).

PROPOSAL

We propose a procedure for railroads that we believe would provide effective self-help by the parties most directly affected, and in the best position to balance the costs and efficiencies of the proposed merger against mitigative conditions sought. It is a procedure that fosters solutions through negotiated settlements that are almost always more effective than unilateral mandates. And it gives all parties a reasonable mix of leverage and incentives to work out their own problems rather than reregulation or an unworkable case by case agency review of every claim. It is intended to utilizes private sector market-place solutions in a setting that provides reasonable give and take for both sides. It emphasizes negotiated solutions, with enough teeth to provide incentives for real and effective relief to be negotiated.

We propose that the Board institute a mechanism to retain competition by requiring privately negotiated solutions, supplemented with an Alternative Dispute Resolution (ADR) procedure to ensure its effectiveness. This proposal utilizes limited ADR to encourage merger applicants and negatively affected railroads to negotiate effective solutions tailored to the individual competitive problems created by mergers. If the parties disagree either as to the harm or the remedy (as measured by clearly articulated standards set forth by the Board), either issue will be subject to prompt arbitration. If the parties cannot reach agreement, a private STB-sanctioned arbitrator (funded by the parties) will resolve (a) whether the party claiming harm is actually being harmed by the merger and (b) what merger conditions are necessary to promote and maintain reasonable competition for the harmed party. This is not a complicated procedure. It formalizes what happens today, but gives it some teeth by providing for an independent arbitrator to compensate for the lack of resources available to the STB. It requires no new bureaucracy, and contains reasonable checks and balances sufficient to provide real incentives for the parties to work out their problems through private negotiations. It also defines the standards upon which relief will be granted in the present world of super concentration within the rail industry.

This proposal envisions that the ADR arbitrators function as an extension of the STB, providing staff and adjudicative support to delve deeper into the real world practical impacts created by mergers, and to assist in encouraging impacted parties to negotiate agreements to address defined impacts. It is a self funded mechanism, paid for by the parties most directly involved and in the best position to avoid such costs by recognizing and resolving real substantive problems raised. Costs could be allocated at the discretion of the arbitrator so as to (a) encourage resolution of substantive problems by assessing costs to applicants unwilling to reasonably address clear harms, (b) discourage frivolous claims by assessing costs to claimants not materially affected by the merger, and (c) recognize resource ability differences in cases where neither party is at fault for requiring arbitration.

For this proposal to work the STB needs to take several actions in its proposed rulemaking. Each of them are listed below, along with background/rationale analysis and a suggested approach for each:

a) **Action 1:** Rewrite the general policy statement, recognizing the intense industry concentration, its cumulative impacts in reducing competitive options for regional and shortline railroads, and need for more effective competition. This statement should establish a policy of seeking opportunities to increase connectivity opportunities wherever reasonably possible.

Background/rationale for Action 1: As the ASLRRA testimony and that of many individual members underscored, recent mergers have had a very negative impact on smaller railroads' ability to access markets for their customers. The mergers to date have resulted in both steel and paper barriers which artificially or unnecessarily prevent what in many cases could be effective competition. For this proposal to be an effective solution, it is critical that future consolidations be conditioned upon the reasonable utilization of the combined mega-carrier systems to achieve a much greater level of connectivity between the remaining railroads -- particularly the smaller roads that have greater flexibility to coordinate operational and marketing efforts, as discussed in more detail below.

Proposed Rule Change to Implement Action 1: Amend 1180.1(a) to reflect that "the Surface Transportation Board encourages private industry initiative that leads to the efficient utilization of the nation's rail facilities. In determining the efficiency of utilization, the Board considers the impact to both applicant and non-applicant facilities. It encourages private negotiation between all affected railroads in order to maximize overall rail facility connectivity and competition, and will aggressively condition future mergers to achieve those objectives in the absence of meaningful private resolution."

b) **Action 2:** Develop articulable substantive criteria of standards so that individual railroads (and the arbitrator, if necessary) can determine whether their respective impacts warrant mitigation relief.

Background/rationale for Action 2: To encourage negotiated solutions, clear standards need to be established to provide parties reasonably clear guidance as to who qualifies for relief, and what type of relief can be expected. This requires substantive policy direction from the Board.

<u>Promote regional and shortline connectivity.</u> Major rail consolidations in recent decades have significantly limited the ability of regional and shortline railroads to interconnect.[1] As part of future mergers, the Board should institute a policy of encouraging interconnectivity with and between regional and shortline railroads through the elimination of paper and steel barriers within the control of the merger applicants, as explained in our testimony before the Board earlier in this proceeding (attached hereto as Appendix A). These barriers should be removed wherever a claimant can establish (a) a present or reasonably foreseeable diminution of competitive alternatives for claimant's customers, and (b) that elimination of such barrier would alleviate the harm to its customers and/or promote new opportunities for its existing or prospective customers.[2] Merger applicants should be required to make reasonable concessions in order to maintain and wherever feasible expand competition beyond what is available in the market pre-merger, unless it is unreasonable to do so. The reasonableness of the remedy would be left to the parties to develop, and in the event they failed to achieve a consensus, arbitration would determine what if any relief was reasonable under the circumstances.

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[1] This is so primarily because many major roads have lost incentives and ability to work with shortlines. Many have either lost competitive incentives because they now own another route/source, or they have become less approachable. The latter point is explained in detail in the ASLRRA testimony. With the advent of expensive e-commerce networks of large carriers and other industry trends, this situation is likely to worsen.

[2] It is important to include prospective customers for a number of reasons. With assured or improved competitive options, the prospects of adding new customers makes infrastructure investment far more likely. Loss of competitive alternatives is harmful to maintaining the type of environment necessary to encourage growth and innovation in the marketplace. The harm caused is no less real because the opportunity for the Class II is not ripe by the time of the merger. This is very much part of the "cumulative impacts" analysis required today, which also requires a rule change (given the amount of public discussion on that issue, it is not discussed in this filing other than to emphasize the wisdom of and need for considering the cumulative impacts of mergers). The idea is to preserve the competitive environment to encourage innovation and growth. The balance is to require that the opportunity be realistic so that merger cases do not drift into an endless debate about futuristic "possibilities", no matter how remote. This requires a common sense test that arbitrators (following STB rule guidance) can resolve expeditiously. Costs assessed against parties filing frivolous claims in this regard will be an effective deterrent against abuse. Additionally, in order to prevent prospective opportunities from being abused, the relief granted could in appropriate cases be conditioned on achieving the opportunity.

We propose that any railroad which can demonstrate that a proposed merger is likely to materially harm its opportunity to pursue or maintain competitive rail options qualifies for relief. It is important that relief is not limited to railroads that have a physical connection with a merger applicant. And it is important that realistically achievable prospective connections be considered. The test should be whether the proposed merger could reasonably be expected to limit competition -- current and reasonably foreseeable. For example, DM&E does not today have a physical connection with the Canadian National Railroad (CN). However, with a modest investment and/or coordination with other smaller railroads, it is easily achievable. The competitive environment today is such that it likely will move via the CN. It becomes highly unlikely if CN merges with BNSF. That movement should be protected if competitive opportunities are to be preserved.

Proposed Rule Change to Implement Action 2: Amend 1180.1(c) (Public Interest Considerations) to make clear that the STB encourages maintaining and promoting competition (existing and prospective) to protect the shipping public in future consolidations wherever practicable. Replace formalistic measures which do not consider many real world practical impacts (e.g., the two-to-one test) with a commitment that competition will be preserved and enhanced unless there is no reasonable means to achieve that end and/or to do so would undermine benefits achieved by the merger that outweigh the unmitigatable harm.

c) **Action 3.** Articulate the types of mitigation measures it will consider under what circumstances so as to provide meaningful guidance to private negotiators and arbitrators alike. Clarify that STB will take a more aggressive posture in mega merger cases in granting trackage rights, haulage agreements and divestiture to maintain and promote competition. This is justified because of the more concentrated state of the industry today. While they may be more aggressive than in past cases, the types of mitigation envisioned here are not more aggressive than in other industries (e.g., compared to what realistically might be expected if the Justice Department review). Also, articulate a policy of strict scrutiny in considering whether to eliminate paper barriers as a condition of merger to allow maximum utilization of the national rail infrastructure through interconnectivity.

Background/rationale for Action 3: For this process to be effective, the Board needs to make clear to the parties and arbitrators that the relief sought must be effective and measured to the harm created. It would require clear direction from the Board that given the heightened concentration of the rail industry, remedies to effectively eliminate steel barriers (e.g., providing trackage rights, requiring haulage agreements, and even divestiture) will be granted more liberally than with past mergers when necessary to maintain and promote competition, and where it can be done without seriously undermining the benefits of the new merged entity.

Doing so will promote stability and greater investment in the remaining rail infrastructure.

Encourage creativity. It is important to encourage the parties to seek creative solutions to the issues raised. It is equally important that the rules provide enough guidance to the parties (and if necessary the arbitrator) so that there is sufficient motivation to complete a private agreement that provides effective remedies. It is not intended to limit recommending more creative and efficient mitigation measures. What works well in one situation may not work well in another. With DM&E's project, it is important that there is enough certainty with the type of mitigation reasonably expected so that investment can be made with some comfort that it will not be lost to the elimination of competition resulting from a merger.

Paper barriers. Our definition of paper barriers is the contractual restrictions to trade enforced as part of the original "spin off" sale of the smaller line from the Class I. It is recognized that contracts cannot and should not be unilaterally vitiated except in the most extreme circumstances. We do not propose to do that. But we do propose that where a reasonable argument can be made that the merger could negatively impact the small railroad in a manner not contemplated when the original contract was entered into, it is subject to altering or being vitiated altogether as a condition of the merger. In short, where the merger would change the ground rules upon which the original deal was structured, then the most anti-competitive parts of those agreements should be eliminated. We actually prefer simply doing away with all paper barriers of merger applicants across the board, as suggested by the ASLRRA. That would be consistent with the Board's public interest mandate. By definition, every one of them serve a blatantly anti-competitive purpose which harms the public by limiting public shipping opportunities. But if the Board feels that is too broad of a brush, we believe there is a very good case to be made to subject them case by case to a showing to the arbitrator that the merger would further undermine the reasonableness of the barriers. As is the case with most such anti-competitive agreements clearly contrary to public interests sought to be protected in merger cases, these agreements should be subjected to strict scrutiny when raised in the context of mergers. There should be an established predisposition to eliminating the blatantly anti-competitive terms of the agreements, with the burden on the applicants to justify their continued necessity post-merger. As a practical matter, most of them would be subject to elimination under this approach. The original intent of how many of these agreements were supposed to work has long since been lost with the radical altering of the competitive landscape and other changes implemented by the resulting mega carriers. This is also an area that would be well suited for the type of offsetting relief for harms which cannot be directly mitigated, as defined below.

Trackage Rights, Haulage Agreements, Divestiture. It should be made clear that these types of remedies should be more readily considered and granted in future merger cases. They are sometimes the only effective remedy available. Parties should be guided to expect the least onerous to the applicant, so long as it effectively addresses the problem raised. For example, for divestiture to be required there should be some showing that (a) the track to be divested is not critical to the merged system and (b) that trackage rights or haulage agreements are insufficient to achieve a competitive environment. For any remedy, of course, it has to be measured to the problem it is trying to address (and its criticality to the damaged party). And that needs to be weighed against the new operational problems it might cause for the merger applicants (and its criticality to the applicant in executing the overall merger plan). Most importantly, the commercial terms and service standards that accompany this type of relief must be such that the smaller railroads can compete effectively. These issues need to be sorted out on a case by case basis, but if the STB makes clear to the parties going into the negotiations that these types of conditions will be invoked where necessary to maintain or encourage competition, there will be a far greater chance that the process of private negotiations will result in a solution that keeps a more level competitive playing field.

Offsets for unmitigatable harm. There are some competitive harms that cannot be effectively mitigated. For those, the parties and/or arbitrator should be encouraged to consider some offsetting relief which, though it may correct a competitive problem not directly created by the merger, will offset problems that are created by the merger but not 100% mitigatable through conditions imposed.

Proposed Rule Change to Implement Action 3: Other than reference in the Public Interest Considerations, no specific rule change is necessary in this regard. But some type of guiding legislative history for the parties and arbitrators is important. A clear articulation that the Board will be more aggressive in requiring pro-competitive conditions is an important component of this history.

d) **Action 4.** Establish definitive procedural timetables for the parties to (a) trigger discussions (through voluntary negotiations or through arbitration) and (b) formulate an effective mitigation proposal for the STB's consideration.

Background/rationale for Action 4: Some type of schedule and procedure is necessary to get the parties talking and move discussions forward. Appropriate discovery for this stage would be allowed, consistent with the STB's existing rules. The specific time-frame and procedure ultimately employed is less significant than that one be employed. An outline is provided below, which could be adjusted to coincide with appropriate milestone dates and events as the Board deems proper.

Proposed Rule Change to Implement Action 4: Amend 1180.4 to include a timetable for negotiation/arbitration relating to affected railroads, commencing on the date STB accepts the merger application (Application Date).

A. Application Date + 60 days. Railroad claiming adverse impact must notify applicants in writing of claimed impacts with specificity, requesting negotiations.

B. Application Date + 75 days. Applicants must in writing either acknowledge impacts or reject them, in whole or in part, specifying in writing the reasons for any claim rejected.

C. Application Date + 100 days. If the parties have not reached consensus as to the competitive harm caused by the merger, they shall have completed a filing detailing their positions sufficient that it may be submitted for consideration to ADR arbitration. Either party may initiate ADR as of this date in order to ascertain definition and extent of competitive harm.

D. Application Date + 200 days. Arbitrator shall issue a finding as to the likelihood that competitive harm caused by the merger, ruling specifically as to the reasonableness could be of the appropriateness of conditions. If potential harm justifies conditions, then parties return to attempt to negotiate specific conditions.

E. Application Date + 265 days. Parties shall agree on conditions to mitigate defined harm, or if no agreement by this date they shall submit the matter to ADR along with their respective condition suggestions.

F. Application Date + 365 days. Arbitrator shall issue finding as to suggested conditions, filed with the STB.

G. This would be the completion of the ADR, with sufficient time for STB review of the findings and recommendations. STB can accept, reject or modify ADR recommendation as it is incorporated in its final merger decision.

It would likely be most beneficial to adjust this schedule to best correspond with the rulemaking schedule established by the STB. Also, the arbitrator could be given considerable discretion for establishing shorter time requirements in cases where the issues are simpler or where the claimant's resources are limited. For example, a small Class III railroad seeking one simple condition need not be dragged through a longer and more expensive process if it is unnecessary.

e) **Action 5.** Establish an Alternative Dispute Resolution mechanism with direction to encourage privately negotiated solutions consistent with the substantive standards set forth by the Board.

Background/rationale for Action 5:

Voluntary. As a practical matter, submitting to arbitration would need to be required as part of the application process. In making the application, the applicants would be required to voluntarily submit to non-binding arbitration (i.e., recommendations to the STB) in the event private negotiations fail.

Resources. A prequalified pool of qualified Arbitrators and an established Alternative Dispute Resolution mechanism for this process already exists. In Ex Parte No. 560, Arbitration of Certain Disputes Subject to the Statutory Jurisdiction of the Surface Transportation Board (Decision served Sept. 2, 1997), the Board created an arbitration procedure for matters within the jurisdiction of the STB. With minor alterations, 49 CFR Part 1108 (Arbitration of certain disputes subject to the statutory jurisdiction of the STB), this structure is well suited to this type of process.

Procedure. Applying the standards established by the Board, the first matter to be arbitrated would be whether the third party railroad has a prima facie claim for relief. If so, the arbitrator could order the parties to negotiate, hopefully resulting in a private agreement without further involvement by the arbitrator. Failing that, the arbitrator could hear the substantive arguments of both sides both as to the extent of harm caused by the merger and the reasonableness of the relief proposed by each party.

Cost. The parties should bear the cost of arbitration, as allocated by the arbitrator. In allocating costs, the arbitrator should take into consideration the reasonableness of the parties in private negotiations. For example, in the event the arbitrator determines that the railroad seeking relief brought forth a frivolous claim based on the facts, he or she may rule that all arbitration costs be borne by claimant. Where the merger Applicant is found to have been unwilling to attempt a reasonable compromise in a case of relatively clear harm where the remedy sought would not be unreasonable, the merger applicant may be required to pay all costs. In extremely close cases that legitimately required arbitration, they might be allocated 50/50, but the prevailing party should generally speaking be expected to pay less than the losing party. This will help provide effective incentives for the parties to deal in good faith, and to deal to a successful conclusion. This should not present an onerous burden on any applicant. Costs will be minimized so long as they deal with legitimate claims in good faith.

Proposed Rule Change to Implement Action 5: Amend 49 CFR Part 1108 to permit non-binding arbitration of claims in merger cases.

f) **Action 6:** Standardize oversight.

Background/rationale for Action 6: As the STB has done in past cases, maintaining a standard oversight and enforcement period for mergers would be beneficial.

Proposed Rule Change to Implement Action 6: This should be accomplished either through a formal rule with a standard oversight time-frame, or on a case by case basis. So long as the STB makes clear in this proceeding that future cases will include an effective oversight period, the means by which it is implemented is less significant.

CONCLUSION

There are hundreds of shortline and regional railroads throughout the country that could provide far more effective and competitive services to their customers, and provide an effective alternative to the problems resulting from mergers to date, if we were simply allowed to work together. This can be accomplished with minimal trackage rights/haulage agreements and other pro-competitive conditions for limited portions of the Class I lines that are being merged. Shortlines and regional railroads can combine to in a way that will provide for true resurgence of this segment of the rail industry. The solutions to many of our most pressing rail industry problems could arise out of the simply ability to connect the smaller lines in a manner that allows us to provide meaningful competition that has been and continues to erode with constant consolidation. This could result in significant private sector reinvestment in these lines, providing far more effective service to our existing customers and paving the way to serve new customers that are hidden from competition through a series of paper and steel barriers preventing alternative competition.

Respectfully submitted,

Kevin V. Schieffer

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KEVIN V. SCHIEFFER • President & CEO

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Mr. Vernon Williams
Secretary
Surface Transportation Board
1925 K Street NW
Washington, DC 20423-0001

RE: STB Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed for filing please find the original and ten copies of my written comments to be presented on behalf of the Dakota, Minnesota & Eastern Railroad Corporation at the above referenced public hearing. Also enclosed is a diskette of this document on a 3.5-inch IBM-compatible floppy diskette. It is my understanding that DM&E has been allotted time for comment to take place on Wednesday, March 8th. Thank you for your consideration in this matter.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Kevin V. Schieffer
President and Chief Executive Officer

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Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

Public Views on Major Rail Consolidations

TESTIMONY OF
KEVIN V. SCHIEFFER
PRESIDENT & CHIEF EXECUTIVE OFFICER
DAKOTA, MINNESOTA & EASTERN RAILROAD CORPORATION

Dakota, Minnesota & Eastern Railroad is an 1,121-mile regional railroad operating in five states (WY, SD, MN, IA, & NE). It was created in 1986 from a line the former C&NW Railroad attempted to abandon. Recovering the infrastructure that was allowed to deteriorate through years of deferred maintenance remains our most significant challenge. Our primary commodities are grain and other agriculture related products, clay, wood and paper products, and cement. We currently have pending before the STB an application to construct and operate a third rail line into the Wyoming Powder River Coal Basin ("PRB") for the purpose of, among other things, (a) improving service and injecting new competition into the important PRB market, (b) preserving and improving service in DM&E's existing market area, and (c) relieving pressure on an overtaxed national rail infrastructure system (STB Finance Docket No. 33407). That project would also result in the complete rebuilding of our existing mainline. DM&E's testimony is intended to highlight the DM&E-specific impacts and broader industry concerns that, without adequate pro-competitive conditions, the imminent CN/BNSF merger and the inevitable round of mergers to follow will create. It will also outline the kinds of conditions that could protect and enhance competition within the industry.

I. DM&E-SPECIFIC IMPACTS. The following are examples of the kinds of effects the mega-mergers are expected to have on DM&E specifically:

(a) **Current Customer Service Threatened, Competition Lost.** The CN/BNSF merger and the inevitable mergers to follow will, without competitive safeguards, have a devastating impact on DM&E's current customer base -- which is primarily agriculture related.

(i) DM&E market access opportunities to the former IC (which CN just acquired in a merger approved by the STB last year) would be immediately lost to the CN/BNSF deal. This includes important agriculture markets for our customers such as the Gulf market, Iowa ag processors, Chicago markets, Omaha and Kansas City markets, and the Twin Cities market.

(ii) a probable follow up merger would involve the Union Pacific (UP) and -- either directly or indirectly -- the Canadian Pacific (CP). This would eliminate or diminish an existing competitive connection DM&E customers today enjoy with CP.

(iii) with both BNSF and UP acquiring basically all the properties that today serve as existing or potential DM&E competitive carriers, DM&E would have neither the reality of competitive alternatives nor the threat of any competitive response to unreasonable practices. This would eliminate effective competitive options for existing DM&E shippers today.

(b) **PRB Construction Project Undermined, Remaining Viability Threatened.** For the same reasons, the CN/BNSF merger and the inevitable mergers to follow will, without competitive safeguards, make implausible any prospect of accomplishing our proposed PRB expansion and reconstruction project. The two major US carriers likely to compete for supremacy coming out this new round of mergers (i.e., BNSF and UP) coincidentally are the only two carriers currently serving the PRB today. They also both are our major connections today. As such, neither of them would have any realistic incentive to accept traffic at the east end of the DM&E system for delivery to the markets beyond. And both of them have every incentive to constrain our market access via competing carriers on the eastern end of our line (e.g., CN or CP). The mergers themselves would have the effect of eliminating the vast majority of competitive connections on the east end of our system. The project relies on a competitive marketplace for delivery beyond DM&E's system. That exists today, but would be eliminated by the mergers. For the STB to approve these mergers without strong pro-competitive conditions -- significantly more aggressive than has been applied in the more recent mergers -- would have the same effect as denying DM&E's PRB construction permit application. Without competition, the project would no longer be feasible.

The mega-mergers would also hasten an inevitable demise of the current DM&E system as it exists today. That would equally have a devastating impact on agriculture and other rail-based industries in DM&E's service area. DM&E's infrastructure is in serious need of major overhaul. This project is the only known opportunity for that to be possible. With the lost PRB opportunity, so too is our opportunity to improve dramatically service to our existing customers -- or even to sustain existing service in the long run.

II. INDUSTRY IMPACTS. We believe the mega-mergers will also have broad regional and shortline industry impacts, including:

(a) **Existing Competition Lost.** Clearly, mega-mergers have the immediate impact of eliminating existing competition. An obvious example from the CN/BNSF case for illustration purposes is the Sioux City, IA to Chicago route in our own market area, which is important to agriculture. Both the BNSF and the CN today have competing routes between those two cities. After the merger, there would be redundant routes between those two rail hubs, owned by a single entity. Competition would be immediately eliminated. Regarding rail access from our region, the same is true for the Gulf market, the Chicago gateway, Kansas City, Omaha and Iowa. For the industry in the midwest, this is not the end-to-end transaction advertised. It has real and immediate anti-competitive impacts.

(b) **Future Competitive Opportunities Lost.** As significantly, the mega-mergers eliminate prospective competitive connections for many regional and short-line railroads. This is a very significant issue for smaller lines. Most regional and shortline railroads today were created as feeder lines to the railroad from which we came. Many of those deals included provisions tying traffic we originate to the "mother" railroad. Whenever there were foreign railroads crossed by the new shortline, there often existed prohibitions against interchange with the foreign railroads. These "paper barriers" by definition were anti-competitive, and had to be drawn very carefully so as to not blatantly run afoul of legal prohibitions regarding anti-competitive practices. Accordingly, many of these "paper barriers" technically permit interchange with foreign carriers, but establish legal or economic restraints. In other cases, physical blockages from retained track ownership require significant capital expenditures to overcome. But if a traffic base could be developed -- or if the "mother" railroad became too unreasonable -- there were alternatives that could be pursued with foreign carriers. In isolated cases DM&E has done this in the past, such as constructing a new physical interchange track with CP. And the PRB construction project allows us the opportunity to do it in the future -- with CN and CP, for example. As stand-alone railroads not merged into the BNSF or UP, they have every market incentive to be competitive. But as part of BNSF or UP, they have every incentive to block us out of the market -- and the market power to accomplish the task. In the world of increasing consolidation of the Class Is, competitive remedies for anticompetitive barriers are already evaporating. The rate of that evaporation will increase exponentially with the round of mega-mergers that loom on the horizon today.

(c) **Fundamental Alteration of the "Feeder" Concept Justification.** As the real and potential competitive options are eliminated for shortlines, the original feeder concept has been lost. We no longer have an agreement with the railroad from which we came. Indeed, it is not even recognizable in many cases. In our case as an example, we were created from the C&NW. The original 1986 agreement envisioned us in part as a "feeder" line to the C&NW, with the rest of the world potentially open to us as competitive connections. Since then, in 1995 the 5,200-mile C&NW has been folded into the 17,500-mile UP, which in 1996 acquired the 14,000-mile SP. Additionally, indirect connections to terminating carriers dwindle for us as mergers east of the Mississippi continue to limit our alternatives. The CN/BNSF proposal is the most serious example that we have faced to date, but it is a pattern repeated throughout the industry as our competitive alternatives continue to shrink.

It is also noteworthy that the short-line relationship can be significantly changed by the newly merged carrier. As the "mother" road gets bigger and changes hands, shortlines are increasingly inconsequential step-children in the new step-mother's corporate strategies. The mega-mergers will inevitably exacerbate this problem. In the recent BNSF merger we lost significant revenue because of an abrogation of car hire rates. We sized and purchased an expensive set of cars based in part on a BN commitment to permanent car hire rates. Following the merger with Sante Fe, the combined entity used AAR rules to simply vitiate the agreement. The rules change with each restructuring. Up to this point it is only the Class Is who have been allowed to change them. The original feeder concept has been so diluted with the mergers from the last decade that any round of mega-mergers to follow should take a serious look at an across-the-board review of the blatantly anti-competitive paper barriers that prevent improved rail service and greater competitive options to our customers.

III. <u>SOLUTIONS.</u> Meaningful competition in a post-merger world after this round of mergers will require the STB to take a fresh look at providing meaningful pro-competitive relief for us remaining lilliputians if it determines it must create new and vastly bigger giants. To a significant extent, the solution already exists. The regional and shortlines that have been created in the last two decades could formulate a considerable functional system if they were allowed to work together rather than restrained through paper barriers and strategic infrastructure blockades. If the STB will allow us, the regional and shortlines working together could offset many of the problems created and exacerbated by the increasing industry consolidation.

(a) **Shortline Alliances.** First, the STB should be commended for its sensitivity to date and its proactive approach to this issue. But the only way to prevent the inevitable anticompetitive environment envisioned by the new round of Class I mergers is to either deny the merger application(s) or impose more effective pro-competitive relief than has been demonstrated to date. This requires no new legislation. Existing statutory authority allows the STB to build on existing caselaw for effective relief in today's super-saturated world of Class I concentration. Specifically, more pro-active efforts to eliminate paper barriers, grant trackage rights and require limited divestiture are critical. An over-arching goal ought to be to allow the very significant confederacy of regional and shortline railroads to work together in union, to interchange traffic and form alliances in ways that are today prevented by artificial "paper barriers" and strategically placed "steel blocks" of rail which physically preclude interchange. Those need to be identified and eliminated in the merger proceedings as they apply to the merger candidates. One of the conditions of entering the world of mega-carriers ought to be allowing the little guys to work together without interference. Shortlines can utilize the considerable resources and ingenuity that is out there, but not if we continue to be held back by these anti-competitive barriers that no longer serve a legitimate purpose in the post-merger world.

(b) **Eliminate "paper barriers" and "steel blocks".** This does not require re-regulation. There are marketplace solutions. The innovative marketplace of the shortlines and regionals is the solution, if it is allowed to function. The STB needs to allow the smaller lines enough flexibility to form effective networks of their own, relying on elimination of paper barriers and/or granting minimal trackage rights over -- or segment divestitures of -- small pieces of the merging mega carriers' systems. One significant problem in this regard is the uncertainty as to "who" is going to be the next merger pair, and how its impacts can be effectively addressed before we know who is going to join next or what correlation that pairing has to the last merger approved. If the exact solution has to be formulated during the pending merger preceding, it is always going to be too early to see what happens next. And when it does, it will be too late to address the corollary impacts of the merger just approved. Another problem is that the mind-numbing detail involved in each paper barrier and each strategic route block will not allow the STB to effectively oversee each and every case. A possible solution to both problems is to place a generic condition on future mega-merger roads to the effect that they must make accommodations for an effective regional and shortline network, within defined criteria. Where the two roads cannot reach agreement after a defined time, it could be a matter for arbitration, subject to full STB review. There are numerous other means to this end, but the key ingredient is to provide for the effective coordination and interconnection of regional and shortlines so that we can effectively work together. Some reasonable definition as to what constitutes a mega-merger will prevent interfering with appropriate feeder line concept agreements that remain true to the original signatories. This will have the combined effect of both regenerating ingenuity in the marketplace and ameliorating the anti-competitive impacts of the mergers.

IV. CONCLUSION. The industry is already too concentrated for a truly vibrant shortline and regional railroad industry. The already excessive concentration that has occurred among Class Is since most shortlines were created has placed us at a significant competitive disadvantage from the time the "feeder line" concept was created. The competitive relief valves that made that system bearable a decade ago are disappearing. The inevitable round of mega-mergers triggered by CN/BNSF will render the once vibrant shortline success stories into helpless pawns with no options.

For DM&E specifically, going forward with this round of mergers likely will kill the most encouraging shortline success story for a railroad that is trying to use some ingenuity to rebuild and make dramatic improvements in the rail industry -- unless the STB determines to take a more aggressive pro-competitive role in granting conditions than was applied to the last round of mergers. The early indications in that regard -- including this opportunity for hearing the concerns throughout the industry -- are very positive and encouraging. Thank you for the opportunity to present our views at this preliminary stage, and the sensitivity you have demonstrated for this issue.

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of May, 2000, I have served a copy of the foregoing Comments of Dakota, Minnesota & Eastern Railroad Corporation on all persons designated as a Party of Record in this proceeding by postage pre-paid, first-class United States mail.

Kevin V. Schieffer

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